Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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In the Matter of	)
Access Charge Reform	) CC Docket No. 96-262
Price Cap Performance Review for Local Exchange Carriers	) CC Docket No. 94-1
Transport Rate Structure and Pricing	) CC Docket No. 91-213
Usage of the Public Switched Network by Information Service and Internet Access Providers	) CC Docket No. 96-263

COMMENTS OF THE NEW YORK STATE DEPARTMENT OF PUBLIC SERVICE

FILED BY
THE NEW YORK STATE
DEPARTMENT OF PUBLIC SERVICE

Dated: January 29, 1997
Albany, New York

Before the
FEDERAL COMMUNICATIONS COMMISSION
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COMMENTS OF THE NEW YORK STATE DEPARTMENT OF PUBLIC SERVICE

INTRODUCTION AND SUMMARY

The New York State Department of Public Service (NYDPS) submits these comments in response to the Commission's Notice of Proposed Rulemaking in the above-captioned proceeding, released December 24, 1996.

The NYDPS supports the Commission's proposals to reduce interstate access charges to reflect true cost savings[1]. However, we disagree with the Commission's proposals that would effect a wholesale restructuring of interstate access charges. To the extent that the Commission must revise interstate access charges to reflect true cost reductions and growth, to

[1] E.g., proposals to remove "equal access network reconfiguration" costs (para. 293) and to re-initialize price caps based on current capital costs (para. 228).

accommodate changes to the existing federal universal service support mechanisms identified by the Joint Board[1], and to resolve its Transport Interconnection Charge (TIC) issues, it should do so in a manner that does not impose rate increases, particularly through end user charges on small- and medium-sized business and residential consumers.

I. THE COMMISSION SHOULD REDUCE ACCESS CHARGES TO REFLECT COST SAVINGS AND GROWTH

The Notice mistakenly attempts to cloak wholesale interstate access charge reform with the mantle of the Act (para.39). The Act requires interstate access charge reform only to the limited extent of establishing an explicit recovery mechanism for the existing universal service support programs identified by the Joint Board. As the Notice recognizes, however, there are other factors that may justify interstate access charge reductions. These include, for example, the possibilities that current price caps should be adjusted downward to reflect lower capital costs (para. 228); that higher productivity factors are appropriate (para. 233); and that equal access network reconfiguration costs, now fully amortized, should be removed from rates (para. 293). All of these factors should be fully evaluated and, if appropriate, corresponding rate reductions mandated.

[1] The Joint Board identified only the High Cost, Dial Equipment Minutes (DEM) weighting, Long Term Support (LTS) and low income (Lifeline/Linkup) programs as universal support mechanisms. As we have stated in our comments in CC Docket 96-45, the Joint Board's recommended replacement for these programs goes far beyond the requirements of the Act and should be rejected.

Beyond these, other factors will likely cause the per minute price of interstate access to fall further in the future. The current growth of interstate access minutes of use[1] should cause per minute prices to decline, because the incremental cost of access is well below the price of access. Moreover, any carrier access charge reductions resulting from this proceeding, if properly flowed through interstate toll rates, should further stimulate access usage and reduce its per minute price.

Changes in the competitive environment and industry structure may also produce cost savings, which should be fully recognized in lower access charges. For example, retail costs allocated to the interstate jurisdiction may be avoided when competitors resell the incumbents' services.[2] Since the Commission has chosen not to pass these savings on to resellers through resale discounts,[3] they should be reflected in lower access charges. Additionally, BOCs entering the interLATA interexchange business (and potentially other new businesses,

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[1] Interstate access minutes of use are growing by approximately eight percent annually. *See*, Joint Board Monitoring Report, CC Docket No. 87-339, May 1996, Table 4.4.

[2] In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, First Report and Order, CC Docket No. 96-98, FCC 96-325, (released Aug. 8, 1996) para. 917-19 (hereinafter "Interconnection Order"); stay granted, Iowa Utilities Board et al. v. Federal Communication Commission, 1996 U. S. App. LEXIS 27953 (8th Cir., Iowa October 15, 1996), app. den., 1996 U.S. LEXIS 6844 (Sup. Ct., November 12, 1996).

[3] Interconnection Order, paras. 873-74 and 980-84. The Commission determined that exchange access services, including SLCs, are not subject to the resale discount.

such as video) may be able to utilize some existing network and operational resources, including common overheads, in those endeavors. To the extent this is true, the associated costs should be transferred from existing services, including interstate access, to the new interLATA operations. Further, the interstate portion of cost savings resulting from industry structure changes, such as the Bell Atlantic/NYNEX and PacTel/SWBell mergers, could be identified and removed from interstate access prices.

Attachment 1 shows potential interstate access price reductions that can reasonably be expected from such cost savings and growth opportunities. All potential opportunities for access charge reductions to reflect cost savings and growth should be fully investigated and, where appropriate, implemented. The Commission should then ensure that any resulting carrier access charge reductions are fully flowed through to consumers through toll rate reductions. While we would like to believe that the interstate toll market is sufficiently competitive to effect such retail price reductions on its own, the recent price increases by AT&T, MCI, and Sprint raise concerns that interstate carrier access charge reductions might not lead to comparable interstate toll rate savings for all classes of customers.

II. PROPOSALS TO INCREASE, DIRECTLY OR INDIRECTLY, THE SUBSCRIBER LINE CHARGE ("SLC") AND OTHER END USER CHARGES SHOULD BE REJECTED

The Joint Board did not, and the Commission should not, find that the recovery of a portion of common line costs through interstate carrier access charges constitutes a universal service support that must be made explicit under the Act.[1] On the contrary, the loop (and other "fixed" costs associated therewith) consists of facilities necessary for the creation of communication paths between two or more users. Consequently, the loop benefits not only the subscriber to that loop but all those who use that loop to complete a connection to that subscriber (hence the name "common line").[2] Therefore, it is reasonable to expect that rates for all services that utilize the loop should recover a portion of its costs.[3] Moreover, such a result may not be inconsistent with efficient pricing, once the relative demand for those services is considered.[4]

Interstate carrier access charge reductions need not result in SLC increases for multiline business customers and for

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[1] The premise that so-called "fixed" costs must be recovered through non-usage sensitive rates (paras. 55-56) as a pre-condition for competition is specious at best. Many enterprises recover their "fixed" costs through the per unit prices they charge for their goods, rather than through up-front subscription fees.

[2] The Commission's rules recognize the common cost nature of the loop, defining it as "Subscriber or common lines that are jointly used for local exchange service and exchange access for state and interstate interexchange services." 47 C.F.R., Part 36.154. *See also,* Interconnection Order, para. 678.

[3] Indeed, Congress, in Section 254(k), mandated that universal service (i.e., primary residential and single line business under the Joint Board's recommendation) bear only a reasonable share of such common costs.

[4] A recent FCC staff analysis recognized that efficient pricing requires consideration of both demand and costs. See, "The Use of Computer Models For Estimated Forward Looking Economic Costs," Common Carrier Bureau, January 9, 1997.

residential customers subscribing to additional lines (para. 65). On the contrary, as explained in Attachment 1, we believe carrier access charge reductions of 50% or more over the next few years should be obtainable without SLC increases. Moreover, recent statements asserting that additional lines are highly profitable for the LECs[1] suggest there is no need to increase the prices (SLCs) of these lines in particular.

We also disagree with the Commission's alternative proposal that would allow incumbent LECs to charge SLCs that exceed the per-line loop costs assigned to the interstate jurisdiction. There is no justification for allowing incumbent LECs to recover more than the cost of providing the loop. Indeed, such a pricing policy is antithetical to the Commission's avowed belief that prices should be driven to "forward-looking" cost. Giving incumbent LECs the flexibility to raise the SLC above the cost of providing service is tantamount to an invitation for rate increases targeted to consumers living in areas not subject to competition.

In the long term, competitive markets will determine how best to recover loop costs, relative to market pressures. Customers also will have choices, and the ability to switch local

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[1] See, e.g., comments of Raymond Smith, Chief Executive of Bell Atlantic: "Sales of secondary lines at Bell Atlantic increased more than 50 percent, fueled by surging demand for Internet and telecommuting applications.... The revenue generated substantial profit because we were able to provision new lines and services from idle capacity in an existing plant." "Industry: Internet No Burden on Phone System," Reuters (as reported in Yahoo), January 23, 1997.

and toll carriers in order to find the best mix of price and service options that meets their needs. In some instances, carriers may elect not to impose an end user surcharge, such as the SLC, as a condition of subscribing to service. As a result, competition will remove the need to have federally-imposed rates for recovery of loop costs, such as the SLC. Until that competitive local exchange marketplace arrives, however, raising the SLC cap is likely to result only in increased monthly local service bills for residential and multi-line business customers. Should the Commission nonetheless decide to increase end user charges to fund interstate access charge reductions, it is imperative that these reductions be flowed through to end users in the form of lower toll rates, preferably to the same classes of customers that will bear the increases.

Finally, the Commission seeks comment on whether geographic averaging of SLCs is an implicit subsidy that is inconsistent with the requirements of Section 254(e) (para 67). We do not believe that Congress viewed the geographic averaging of a carrier's prices, despite non-uniform costs of serving different areas, as a subsidy that must be made explicit. Indeed, the Congressional mandate (Section 254(g)) for toll rate averaging supports our interpretation. While the NYDPS does not believe the Act requires geographic deaveraging of SLCs, if the Commission intends to pursue such deaveraging, the issue should be referred to the Universal Service Joint Board since the price increases that will result in some (presumably less densely populated) regions raise affordability concerns.

CONCLUSION

For the foregoing reasons, the NYDPS encourages the Commission to reduce interstate access charges to reflect identifiable cost savings and growth. We further recommend that the Commission limit its access rate restructuring to those actions necessary to make explicit recovery of the existing universal service support mechanisms identified by the Joint Board. Finally, we recommend that the Commission not prescribe the recovery of common line costs through increases in subscriber line charges on residential and business customers.

Respectfully submitted,

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Comments of New York State
Department of Public Service

CERTIFICATE OF SERVICE

I, Mary E. Burgess, hereby certify that an original and sixteen copies of the comments of the New York State Department of Public Service in the above-referenced proceedings were delivered by hand to Mr. Caton. Copies were sent by First Class United States Mail, postage prepaid, to all parties on the attached service list.

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INTERSTATE ACCESS CHARGES

Potential for Decrease in Absence of Local Service Rate Increases

Introduction and Summary:

The implementation of the new Telecom Act has given rise to the notion that 1) interstate access charges must be reduced and 2) such reductions could put upward pressure on local rates. Those factors which could result in substantial reductions in interstate carrier access, absent local rate increases, are analyzed below.

There are three major factors that should lower access charges over the remainder of the decade. These are:

1) *Continued growth in interstate access minutes (if volume growth exceeds cost growth, then per minute rates should decrease).*

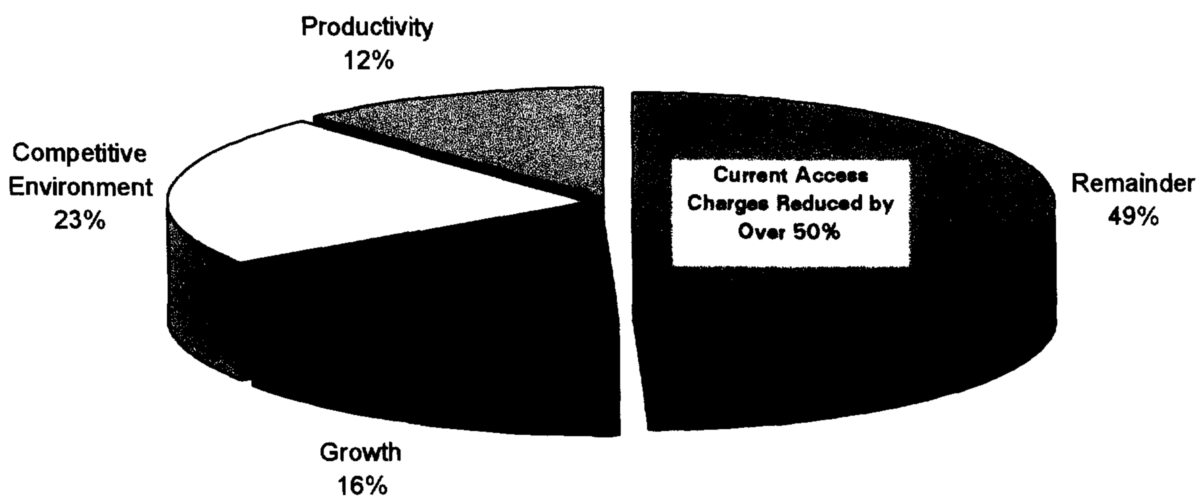
2) *Continued cost savings due to corporate downsizing and other efficiencies driven by increasing competitive pressures.*

3) *Transition to the competitive environment, including revisions to the interstate regulatory framework to ensure that the above factors are reflected in access charge levels as well as a revision to today's access charge levels to reestablish an appropriate starting point reflecting the competitive environment and the new freedoms accorded LECs to enter and compete in new lines of business.*

The following analysis assesses the potential impact on access charge rates of each of the above factors. The analysis uses 1995 as the base year starting point and quantifies the impact of expected changes on interstate access charges through the year 2000. As detailed in the following, interstate access charge reductions in excess of 50% should be achievable over the next few years without any transfer of costs to local service.

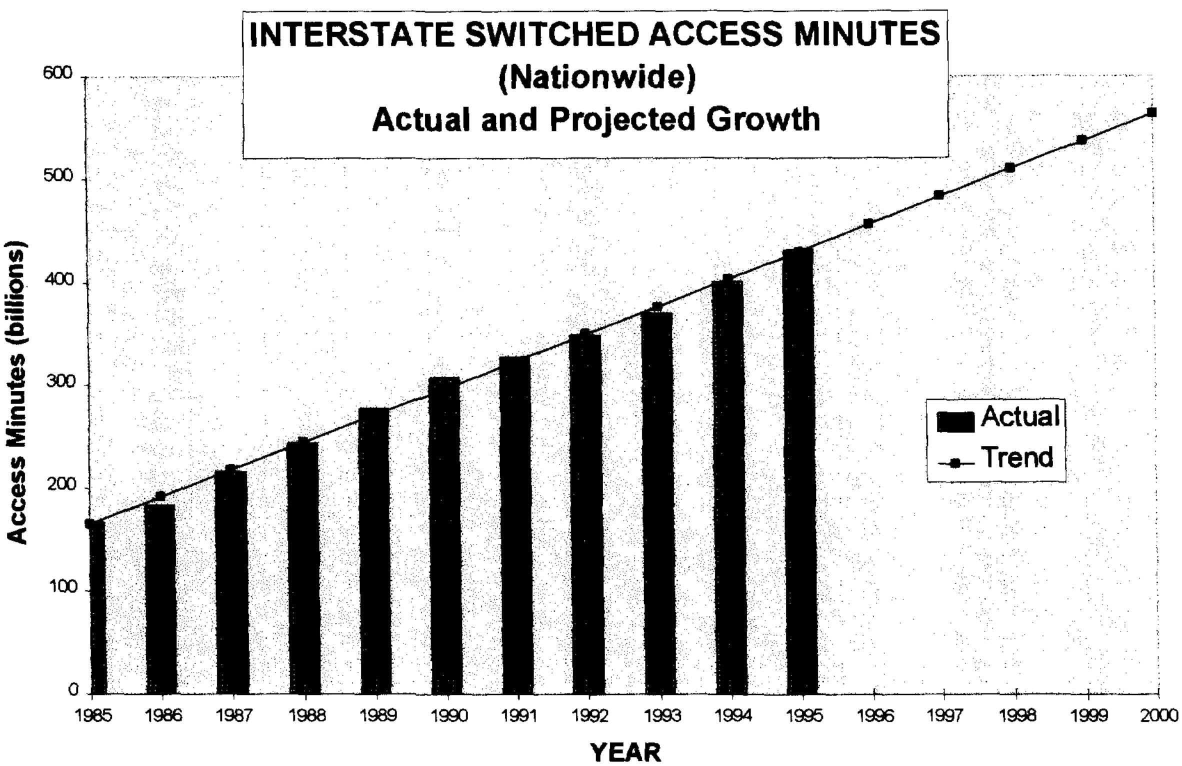
The chart below summarizes the potential for future interstate carrier access charge decreases on an overall nationwide basis due to 1) expected access volume growth, 2) estimated efficiency related cost savings, and 3) implementation of a regulatory approach that reflects expectations under the new competitive operating environment. This significant potential for access charges decreases should fully analyzed and explored before any proposals to shift interstate access cost recovery to local service are entertained.

SOURCES OF ACCESS CHARGE REDUCTION



Interstate Access Growth

As shown in the following chart, interstate access usage has exhibited significant and consistent growth since the inception of access charges. The chart shows both the actual results (through 1995) and the linear growth trend (extrapolated through the year 2000):



It should be noted that interstate carrier access usage has been subject to competitive displacement over the past (via CAPs and direct connects to customers) and still managed to exhibit a significant and consistent growth rate. Since the impact of competition has been reflected in the actual figures, it is reasonable to assume that additional future competitive inroads would not appreciably alter the switched access minute growth rate.[1]

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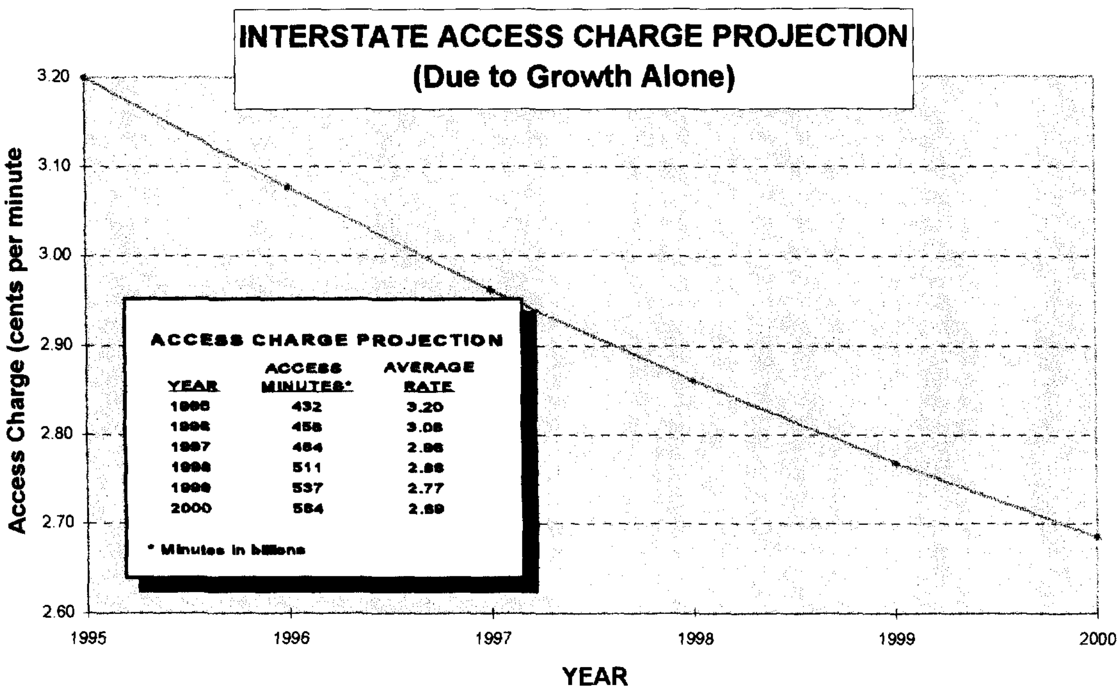
[1] Local exchange competition (i.e., dial tone competition) would not by itself affect the overall volume of switched access minutes. Instead, it would just affect the number of local exchange carriers providing the overall volume of switched access.

Assuming a current incremental cost of $0.01 per minute for interstate access, it would be reasonable to estimate that each additional minute of future access growth would increase the cost of interstate access by one cent.[2] Since 1995 interstate access charges averaged $0.032[3] per minute (which in turn is based on the 1995 level of costs allocated to interstate access), the future average access charge should decline. The following chart shows the expected decline in average interstate per minute carrier access charges, assuming that each additional access minute adds one cent to the total interstate costs to be recovered through access charges.[4]



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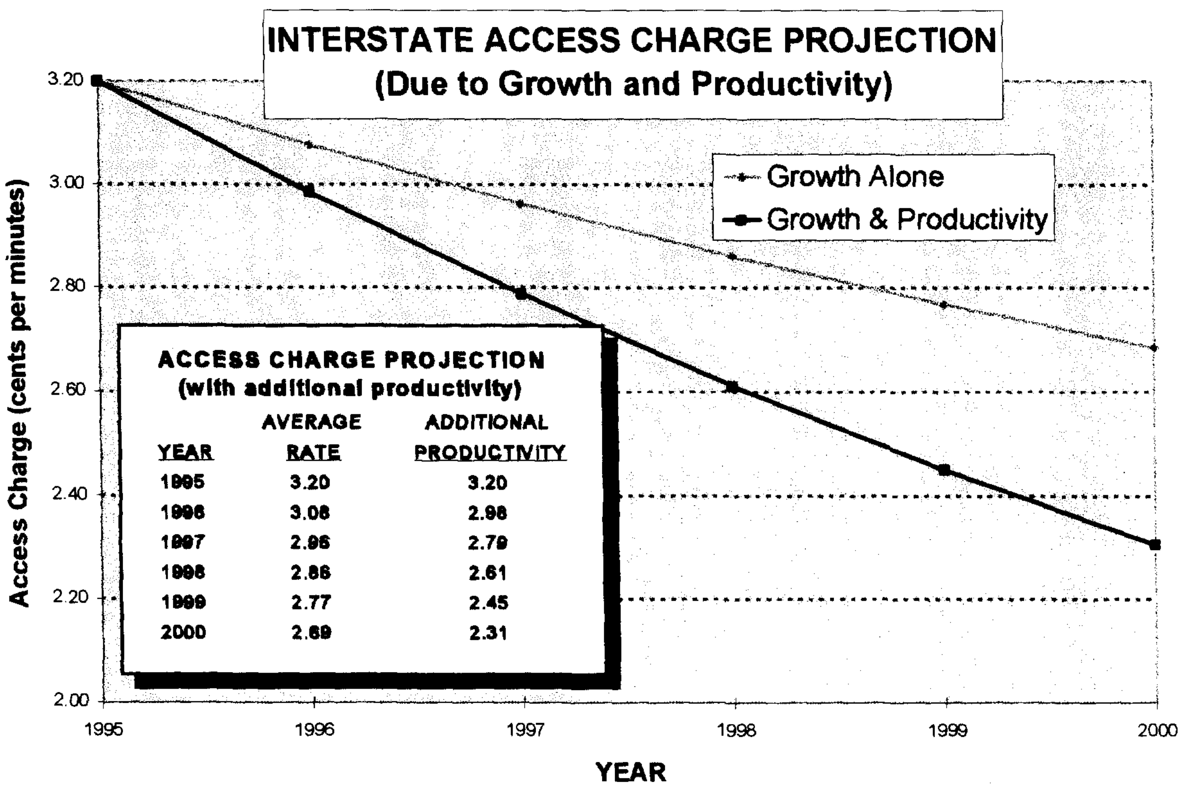
[2] The $0.01 per minute figure is a broad gauge measure of incremental cost and is used illustratively in this analysis. If incremental costs are higher or lower than this amount, then the potential access charge decreases would be lesser or greater than those shown in the chart.

[3] The 3.2 cent figure represents an average of the 1995 nationwide access charges in effect during the year (derived from Tables 5.11 and 5.13 in the Federal-State Joint Board Staff 1996 Monitoring Report).

[4] The Jurisdictional Separations Procedures would govern how much added interstate cost would accompany each added interstate access minute. The amount assigned would depend upon 1) the proportion of usage sensitivity in interstate cost allocation and 2) the amount of intrastate usage growth. The actual interstate cost assignment could be higher or lower than the actual incremental cost; for the purpose of this analysis it is assumed that the jurisdictional allocation equals the incremental cost.

Additional Cost Savings

In addition to the access charge reductions that can be expected to occur due to growth in the volume of access usage, continued efficiency gains due to technology advances and operational reengineering should result in further access charge reductions. Currently, the 5.3% productivity offset adopted by most local exchange carriers in their FCC price cap filings exceeds the current annual rate of inflation by approximately 3%. The chart below shows the additional access charge reductions through the year 2000 under a continuation of this annual net productivity factor. It should be noted that about 70% of interstate carrier access is based on the cost of switching and interoffice transport. Since both these network components are the primary beneficiaries of telecom technological advances, it would be reasonable to expect significant cost savings in these categories.



Competitive Environment Changes

The above interstate carrier access reductions do not reflect 1) an appropriate adjustment in the starting point rates for carrier access (to eliminate the extraordinary increase in interstate earnings levels allowed by the past regulatory approach), 2) the transfer of the risk of recovery of uneconomic costs in embedded plant (a risk that is fully borne by entities operating in a fully competitive environment), and 3) the potential gains available to LECs via their entry into markets that they were formerly precluded from entry. A forward looking regulatory approach should capture these factors via further reductions to access charge levels. The adjustment to an appropriate earnings level alone could result in an approximate 9% reduction.[5] Adding an adjustment of interstate cost levels to remove (either by write-off or amortization) embedded operating costs that do not reflect the cost levels in the future competitive environment could result in annual carrier access price reductions ranging from 0 to 6% - - 3% is used in this analysis.[6] In light of the future increased earnings potential stemming from the Act's new operating freedom such an adjustment could be absorbed by the companies directly and removed from carrier access rate levels. However, the method of eliminating these costs is not critical to the end result of this analysis. The critical factor is that these costs will not be part of the future cost basis for carrier access charges once they are removed. The following chart includes the impact of the above adjustments (totaling 12% - the mid-point of the estimate range) and assumes that they are spread ratably over the five year analysis period.

In addition to the above competitive environment changes, two additional factors may well allow access charges to be lowered even further. First, corporate consolidations, as exemplified by PacTel/SWB and Bell Atlantic/NYNEX, would facilitate the achievement of cost savings beyond the productivity savings currently anticipated. Predicated on information available

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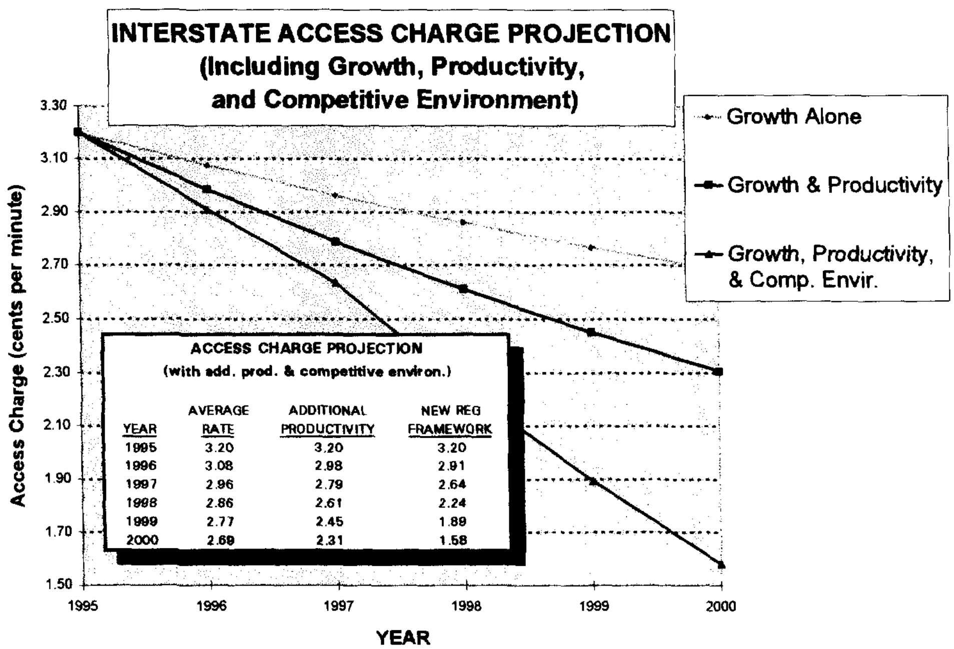
[5] The past regulatory approach has allowed earnings to creep up to a level that would not reasonably be expected to be achieved in a rigorous competitive market. Elimination of past "benefits" now reflected in current access charge levels (e.g., a rollback of the unified tariff approach that allowed access charges to be set at a higher level than otherwise - worth about 1-2% by itself), and resetting rates at an appropriate earnings level (worth 5-10% of rate levels), could result in an additional 6-12% rate reduction. Nine percent is used in this analysis.

[6] One year's worth of interstate earnings (not an unprecedented level based on write-off experiences of other industries undergoing significant market changes) would equal about 30% of one year's worth of access revenues or about 6% of revenues for the five year projection period used in this analysis (i.e., 1996 through 2000). Write-offs taken by BOCs for SEC reporting purposes corroborate this figure. For example, NYNEX reduced its net plant by $3.5 billion via a one-time write-off to reflect the competitive environment. The interstate portion of this amount is in excess of 30% of one year's interstate carrier access revenues.

from the BA/NYNEX merger proposal, the nationwide interstate portion (assuming a 25% interstate allocation) of the estimated savings (expanded to the entire universe of former Bell Operating Companies) would exceed $1 billion annually by the year 2000.[7]

Second, the resale of incumbent telephone company services now being implemented (and facilitated by significant wholesale discounts) will result in substantial operating cost reductions. A portion of these savings (approximately 25% based on current interstate allocations) will accrue to the interstate operation. Assuming a gradual 5% per year penetration of resale competition (starting in 1997 and reaching 20% by the year 2000) and an average avoidable cost estimate of 20% of the retail revenues being resold, the nationwide interstate cost reduction would reach $800 million annually by the year 2000.[8] To the extent that these savings are not used for wholesale discounts, they would be available to fund interstate access charge decreases. The interstate portion of both the resale and corporate consolidation savings, in addition to the above described competitive environment changes, are reflected as potential lower interstate access charges in the following chart.



ACCESS CHARGE PROJECTION
(with add. prod. & competitive environ.)

YEAR	AVERAGE RATE	ADDITIONAL PRODUCTIVITY	NEW REG FRAMEWORK
1995	3.20	3.20	3.20
1996	3.08	2.98	2.91
1997	2.96	2.79	2.64
1998	2.86	2.61	2.24
1999	2.77	2.45	1.89
2000	2.69	2.31	1.58

[7] The magnitude and timing of these savings would, of course, depend upon the degree and timing of industry consolidations. In spite of the uncertainty of future consolidation activity, its potential impact on interstate access charge levels should not be ignored.

[8] Avoidable cost factors developed in state regulatory jurisdictions are mostly in the 20% range used in this analysis. The 20% resale penetration is used for illustrative purposes.